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October 25, 1999

Mr. David Waddell  
Executive Secretary  
Tennessee Regulatory Authority  
460 James Robertson Parkway  
Nashville, TN 37243-0505

**In Re: Petition of ICG Telecom Group, Inc. for Arbitration with Bellsouth  
Telecommunications, Inc. Pursuant to Section 252 of the  
Telecommunications Act of 1996  
Docket No. 99-00377** *Only*  
**and  
Petition for Arbitration of ITC<sup>Δ</sup>DeltaCom Communications, Inc. with  
Bellsouth Telecommunications, Inc. Pursuant to the Telecommunications Act  
of 1996  
Docket No. 99-00430**

Dear David:

Please find enclosed an original and thirteen copies of the Rebuttal Testimony of Cindy Shonhaut and Michael Starkey on behalf of ICG Telecom, Inc. in the above-captioned proceeding.

Thank you for your assistance in this matter.

BOULT, CUMMINGS, CONNERS & BERRY, PLC

By:

*Henry Walker*  
Henry Walker, attorney for ICG

HW/nl

cc: Guy Hicks, attorney for BellSouth

**FILE**

**BEFORE THE TENNESSEE REGULATORY AUTHORITY  
Nashville, Tennessee**

**IN RE: PETITION OF ICG TELECOM GROUP, INC. FOR ARBITRATION  
WITH BELLSOUTH TELECOMMUNICATIONS, INC. PURSUANT TO  
SECTION 252 OF THE TELECOMMUNICATIONS ACT OF 1996**

**DOCKET NO. 99-00377**

**and**

**IN RE: PETITION FOR ARBITRATION OF ITC^ DELTACOM  
COMMUNICATIONS, INC. WITH BELLSOUTH  
TELECOMMUNICATIONS, INC. PURSUANT TO THE  
TELECOMMUNICATIONS ACT OF 1996**

**DOCKET NO. 99-00430**

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**REBUTTAL TESTIMONY  
OF  
CINDY Z. SCHONHAUT  
ON BEHALF OF  
ICG TELECOM GROUP, INC.**

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**October 22, 1999**

1                   **BEFORE THE TENNESSEE REGULATORY AUTHORITY**

2                   **REBUTTAL TESTIMONY**

3                   **OF**

4                   **CINDY Z. SCHONHAUT**

5                   **ON BEHALF OF ICG TELECOM GROUP, INC.**

6                   **DOCKET NO. 99-00377**

7   **Q.     ARE YOU THE CINDY SCHONHAUT THAT CAUSED DIRECT TESTIMONY**  
8 **TO BE FILED IN THIS PROCEEDING?**

9   A.     Yes, I am.

10 **Q.     WHAT IS THE PURPOSE OF YOUR TESTIMONY TODAY?**

11 A.     I would like to take this opportunity to respond to the testimony of Mr. Varner,  
12 particularly his analysis of the various orders of the Federal Communications Commission  
13 ("FCC") and court opinions that have some bearing on the instant proceeding. I will also  
14 respond to Mr. Varner's testimony about reciprocal compensation for calls to ISPs.

15 **Q.     WHAT IS THE PROBLEM, IN GENERAL TERMS, WITH MR. VARNER'S**  
16 **TESTIMONY?**

17 A.     Mr. Varner spends a good deal of time discussing various FCC orders and  
18 corresponding court decisions. In virtually every case, Mr. Varner's point is that this  
19 Authority should not become involved in this issue because the concerns may one day be  
20 addressed elsewhere. Under Mr. Varner's approach, the existence of any legal uncertainty is  
21 cause for competitive paralysis. Mr. Varner preaches inaction and offers no prescription to  
22 break the current regulatory gridlock.

1           The regulatory vacuum that would result from this Authority's inaction would have  
2   significant effects on both ICG and competition within this state. The carriers would be left to  
3   fight out their differences among themselves, with BellSouth the all-but-certain winner in every  
4   instance. In addition, if this Authority does not act on the issues in ICG's petition for  
5   arbitration, ICG will be forever foreclosed from relief for the period before the FCC finally  
6   acts on reciprocal compensation for ISP calls. The delay that ICG and other CLECs face in  
7   having these issues addressed will dictate the speed with which competition begins to flourish  
8   in this state. ICG hopes to continue to provide more innovative services to more customers at  
9   better prices, but this can occur only if the regulatory environment is supportive and attentive  
10   to competitive concerns. To this end, ICG respectfully requests that this Authority act in this  
11   proceeding to bring much needed certainty to the competitive playing field in Tennessee.

12   **Q.     DO YOU AGREE WITH MR. VARNER'S ARGUMENT THAT IT WOULD BE**  
13   **"FRUITLESS" FOR THIS AUTHORITY TO ADDRESS THE ISSUE OF RECIPROCAL**  
14   **COMPENSATION FOR CALLS TO ISPS?**

15   A.     No. While the FCC will eventually take up the issue of how calls to ISPs are to be  
16   compensated, its rule will be prospective only. See Declaratory Ruling and Notice of  
17   Proposed Rulemaking in CC Docket 96-98, released on February 26, 1999 ("Declaratory  
18   Ruling"). If this Authority does not take action to compensate for calls to ISPs, ICG will *never*  
19   be compensated for the calls it delivers to ISPs during the interim until the FCC adopts a rule,  
20   because the FCC rule will be prospective only in application. To compound the adverse  
21   impact on ICG, the interim period until the FCC acts could stretch for several months or even  
22   a year. It previously took the FCC almost two years (20 months) to respond to the June 1997

1 request for clarification that led to the Declaratory Ruling. Letter from Richard Metzger,  
2 General Counsel for the Association for Local Telecommunications Services to Regina  
3 Keeney, Chief, Common Carrier Bureau, FCC (June 20, 1997). If reciprocal compensation  
4 for calls to ISPs were foreclosed as a source of revenue for several months or more, ICG  
5 would be forced to re-think its options concerning its operations in this state. See Schonhaut  
6 direct at 8-9.

7 For its part, the FCC has given the state commissions the proverbial green light to  
8 consider reciprocal compensation for ISP-bound traffic until the FCC adopts a prospective  
9 rule. The Declaratory Ruling states that:

10 Although reciprocal compensation is mandated under section 251(b)(5) only for  
11 the transport and termination of local traffic, neither the statute nor our rules  
12 prohibit a state commission from concluding in an arbitration that reciprocal  
13 compensation is appropriate in certain instances not addressed by  
14 section 251(b)(5), so long as there is no conflict with governing federal law. A  
15 state commission's decision to impose reciprocal compensation obligations in an  
16 arbitration proceeding - or a subsequent state commission decision that those  
17 obligations encompass ISP-bound traffic - does not conflict with any [FCC] rule  
18 regarding ISP-bound traffic.

19 Declaratory Ruling, ¶26 (citations omitted). This language makes clear that this Authority's  
20 consideration of reciprocal compensation will not be "fruitless," as suggested by Mr. Varner.

21 Mr. Varner's argument that the Authority would waste its efforts in addressing  
22 reciprocal compensation for calls to ISPs is particularly weak. He states that the FCC's

1 authority "to confer this ability on the states is being challenged in court." Varner Direct at 3.  
2 He then adds that "states could find they do not have the authority to create even an interim  
3 compensation arrangement" and that the "authority is valid only until the FCC completes its  
4 rulemaking..." Id. In making this argument, however, Mr. Varner concedes that the present  
5 state of the law is such that this Authority has the requisite authority to order reciprocal  
6 compensation for calls to ISPs. Until the FCC acts, only a court order can remove this  
7 authority, but no court has thus far given any indication that it will change the existing  
8 situation before the FCC adopts a rule. Mr. Varner's theory would have the existence of any  
9 legal challenge to an FCC decision result in competitive paralysis. That is precisely the  
10 outcome that this Authority should act to preclude.

11  
12 **Q. WHAT ARE THE CONSEQUENCES TO ICG, OTHER CLECS, AND ISPS IF**  
13 **THIS AUTHORITY DECLINES TO ADDRESS THE ISSUE OF RECIPROCAL**  
14 **COMPENSATION FOR CALLS TO ISPS?**

15 A. In my direct testimony, I set forth a number of the consequences that will befall ICG  
16 and other CLECs if the Authority declines to address reciprocal compensation or otherwise  
17 precludes such compensation. Schonhaut direct at 8-9. In brief, without reciprocal  
18 compensation for delivering traffic to ISPs, ICG and other CLECs would be left to raise their  
19 rates or absorb their costs - either of which would be destructive to their ability to attract and  
20 keep customers. The remaining option would be to decline to provide service to ISPs.  
21 Because CLECs have been much more responsive to the needs of ISPs than ILECs have, the  
22 result would likely be a reduction in the rate of growth of the Internet in Tennessee.

1 ISPs would also be required to make strategic business decisions. If CLECs like ICG  
2 are forced to raise their rates to ISPs because the CLECs are not recovering their cost of  
3 terminating the traffic, it could result in increased costs to end users. There is no way of  
4 knowing how ISPs would handle rate increases, and whether ISP rate increases would  
5 artificially suppress demand for services in such a way that the growth of the Internet in this  
6 state would not reach the levels it otherwise would have.

7 **Q. WHAT IS WRONG WITH MR. VARNER'S VIEW THAT SINCE ISP-BOUND**  
8 **TRAFFIC IS NOT LOCAL TRAFFIC IT IS NOT SUBJECT TO THE RECIPROCAL**  
9 **COMPENSATION OBLIGATIONS?**

10 A. Mr. Varner misses the point of the recent FCC Declaratory Ruling. In that ruling, the  
11 FCC made a *jurisdictional* finding that calls to ISPs when exchanged between two carriers  
12 within the same local calling area in a state are "jurisdictionally mixed and appear to be largely  
13 interstate." FCC Ruling at ¶¶18-20. For compensation purposes, however, the FCC  
14 concluded that calls to ISPs are to be compensated in accordance with the actions of the *state*  
15 *commission* unless and until the FCC adopts a further order governing compensation. Any  
16 FCC order will have prospective application only. Declaratory Ruling ¶¶21-27. In the  
17 interim, the FCC permitted state commissions to *treat calls to ISPs as local for purposes of*  
18 *reciprocal compensation. Id.*

19 **Q. IS THERE ANY BASIS FOR MR. VARNER'S CLAIM THAT RECIPROCAL**  
20 **COMPENSATION FOR ISP CALLS IS NOT A PROPER SUBJECT OF A STATE**  
21 **ARBITRATION PROCEEDING UNDER SECTION 252 OF THE ACT?**

1 A. No. This is simply a variation of Mr. Varner's argument that calls to ISPs are not  
2 local. Mr. Varner reasons that because calls to ISPs are not local, the reciprocal compensation  
3 provisions of Sections 251 and 252 are not implicated, so calls to ISPs cannot be the subject of  
4 a Section 252 arbitration proceeding under his theory. Varner direct at 4-5. The FCC has  
5 already provided the answer to Mr. Varner's theory: calls to ISPs may be treated as local for  
6 purposes of reciprocal compensation until the FCC adopts a new rule with prospective  
7 application only. The FCC concluded in the Declaratory Ruling that:

8 [S]tate commission authority over interconnection agreements pursuant to  
9 section 252 "extends to both interstate and intrastate matters." Thus the mere  
10 fact that ISP-bound traffic is largely interstate does not necessarily remove it  
11 from the section 251/252 negotiation and arbitration process.

12 Declaratory Ruling, ¶25 (citations omitted).

13 **Q. DO YOU AGREE WITH MR. VARNER'S STATEMENT THAT ISPS ARE**  
14 **CARRIERS THAT PURCHASE ACCESS SERVICE?**

15 A. No. ISPs purchase business services out of local exchange tariffs. Mr. Varner  
16 attempts to show that ISPs are carriers, because if they are considered as such, according to  
17 Mr. Varner, the ISPs would be purchasing access service and the CLEC serving them would  
18 not be eligible for reciprocal compensation. The Declaratory Ruling provides the answer to  
19 Mr. Varner's argument:

20 In the Access Charge Reform Order, the Commission decided to maintain the  
21 existing pricing structure pursuant to which ESPs are treated as end users for the  
22 purpose of applying access charges. Thus, *the [FCC] continues to discharge its*



1 *interstate regulatory obligations by treating ISP-bound traffic as though it were*  
2 *local.*

3 Declaratory Ruling, ¶25.

4 Elsewhere in the ruling, the FCC makes clear that, until it adopts a prospective rule,  
5 the consequence of "treating ISP-bound traffic as if it were local" under the access charge  
6 regime suggests that calls to ISPs be subject to reciprocal compensation:

7 While to date the Commission has not adopted a specific rule governing the  
8 matter, we note that our policy of treating ISP-bound traffic as local for  
9 purposes of interstate access charges would, if applied, in the separate context of  
10 reciprocal compensation, suggest that such compensation is due for the traffic.

11 Declaratory Ruling, ¶25.

12 **Q. SHOULD THIS AUTHORITY ADOPT BELLSOUTH'S INTERIM PROPOSAL**  
13 **DESCRIBED AT PAGES 12-17 OF MR. VARNER'S TESTIMONY CONCERNING**  
14 **COMPENSATION FOR CALLS TO ISPS?**

15 A. No. For the reasons set forth in Mr. Starkey's rebuttal testimony, the interim  
16 inter-carrier mechanism suggested by BellSouth is inappropriate. Furthermore, it is outside the  
17 scope of the issues of this arbitration proceeding.

18 **Q. IN DR. TAYLOR'S TESTIMONY, AT PAGES 17 AND 18, HE MENTIONS**  
19 **THAT THREE STATE COMMISSIONS — MASSACHUSETTS, NEW JERSEY AND**  
20 **SOUTH CAROLINA -- HAVE ADOPTED POSITIONS CONTRARY TO THAT URGED**  
21 **BY ICG ON RECIPROCAL COMPENSATION FOR ISP BOUND TRAFFIC. PLEASE**  
22 **COMMENT.**

1 A. What Dr. Taylor fails to mention is since the FCC's February 26, 1999 declaratory  
2 ruling, at least 15 other state commissions have adopted decisions consistent with that urged by  
3 ICG. These states include Alabama, California, Delaware, Florida, Hawaii, Indiana,  
4 Maryland, Minnesota, Nevada, New York, Ohio, Oregon, Pennsylvania, Rhode Island, as well  
5 as this Authority. With regard to Dr. Taylor's reference to the Massachusetts decision, I also  
6 note that the Department of Telecommunications and Energy's ("DTE's") order did not reach  
7 the merits. The DTE merely overruled its earlier order which had been premised on the "two-  
8 call" theory, because that theory had been undercut by the FCC's declaratory ruling.

9  
10 **Q. HAVE THERE BEEN ANY RECENT DEVELOPMENTS IN THE BELL SOUTH**  
11 **REGION ON THIS ISSUE?**

12 A. Yes. On October 4, 1999, the South Carolina Commission held that, "since ISP-bound  
13 traffic is jurisdictionally interstate, such traffic is not subject to the reciprocal compensation  
14 obligation of the 1996 Act." That finding is essentially copied from footnote 87 of the FCC's  
15 Declaratory Ruling. In the same footnote, however, the FCC went on to explain that, even  
16 though the reciprocal compensation requirement in Section 251 does not apply to ISP traffic,  
17 state commissions, nevertheless, "have the authority under Section 252 of the Act to  
18 determine inter-carrier compensation for ISP-bound traffic," at least until a federal  
19 compensation requirement is adopted. Despite the FCC's statement, the South Carolina  
20 Commission apparently agreed with the position taken by BellSouth that state commissions  
21 have no authority to arbitrate issues that are not specifically covered by Section 251.

1 In Tennessee, however, the Authority has already determined that Issue No. 1 in the  
2 ICG petition, whether ISP-bound traffic should be treated as "local calls for purposes of  
3 reciprocal compensation," is a proper subject for this arbitration. In an Order issued  
4 September 13, 1999, the Pre-Arbitration Office ruled, "relative to Issue 1, the Pre-Arbitration  
5 Officer finds that pursuant to 47 U.S.C. § 251(b)(5), matters related to reciprocal  
6 compensation are appropriate for arbitration." On October 12, 1999, this Authority voted  
7 unanimously to affirm the Pre-Arbitration Officer's decision. I do not understand why  
8 BellSouth is trying, through Mr. Varner, to raise this issue a second time.

9 Furthermore, I understand that the United States Federal District Court in Nashville has  
10 issued an Order stating that it is unlikely that BellSouth will succeed in overturning the  
11 Authority's Brooks Fiber decision directing BellSouth to pay reciprocal compensation on ISP  
12 traffic. BellSouth v. Brooks Fiber, docket no. 3:98-0811 (September 30, 1999).  
13 Significantly, the Court cited the FCC's Declaratory Ruling on the ISP issue as supporting the  
14 TRA's decision in Brooks Fiber. Obviously, the Court disagrees with Mr. Varner that the  
15 FCC's ruling is inconsistent with Brooks Fiber or that the ruling deprives this Authority of  
16 jurisdiction to rule on the reciprocal compensation issue in a Section 251 proceeding.

17 Finally, I would like to draw the Authority's attention to the October 13, 1999 decision  
18 of the Arbitration Panel of the Alabama Public Service Commission. In the Matter Of:  
19 Petition by ICG for Arbitration of Interconnection Agreement with BellSouth, Docket No.  
20 27069. The Panel devoted fourteen pages to a thorough discussion of the legal and regulatory  
21 aspects of the reciprocal compensation issue. The Panel concluded that (1) the Commission  
22 has jurisdiction over this issue; (2) the Commission should not delay making a decision

1 pending action by the FCC; (3) BellSouth's proposal to treat such calls as interstate "access"  
2 traffic is "misplaced and totally contrary to prevailing regulatory mandates"; and (4) for  
3 reasons of economic efficiency, reciprocal compensation should be paid for ISP-bound traffic  
4 at the same rate as local voice traffic and that the rate should be based on "the elemental rates  
5 of transport end office and tandem switching" adopted in the Commission's UNE pricing  
6 docket.

7 The Panel's decision covers these points comprehensively and I recommend the  
8 decision to this Authority.

9 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

A. Yes, it does.

1 **Q. Please state your name.**

2 A. My name is Michael Starkey.

3

4 **Q. Are you the same Michael Starkey who previously filed direct testimony in**  
5 **this proceeding?**

6 A. Yes, I am.

7

8 **Q. What is the purpose of your rebuttal testimony?**

9 A. My rebuttal testimony will respond to a number of arguments made by BellSouth  
10 Telecommunications, Inc. ("BellSouth") in its direct testimony regarding ICG  
11 Issue No. 1 (reciprocal compensation for ISP-bound traffic).

12

13 I. I respond to arguments raised by BellSouth Witness Alphonso J. Varner  
14 describing BellSouth's duty (or lack thereof) to compensate ICG for ISP-  
15 bound traffic. Specifically, I disagree with BellSouth's position that the  
16 Tennessee Regulatory Authority (hereafter "the Authority") should simply  
17 not address this extremely important issue within the context of this  
18 arbitration.<sup>1</sup>

19

20 II. I address a number of arguments raised both by Mr. Varner and by Dr.  
21 Taylor as to why ICG should, instead of receiving reciprocal  
22 compensation payments for carrying BellSouth's traffic, pay BellSouth for  
23 carrying that traffic or revert to a bill-and-keep arrangement though it is  
24 my understanding that this testimony is subject to a motion to strike. I  
25 conclude that Mr. Varner, Dr. Taylor and BellSouth have, with this  
26 argument, so twisted the FCC's decisions and the rubric of common sense  
27 to the point where BellSouth's proposals can't be taken seriously.

28

29 III. Finally, I respond to Dr. Taylor's argument that "the principle of cost  
30 causation" requires the Authority to view calls made to an ISP in the same  
31 context as calls made to an interexchange carrier. I disagree with Dr.  
32 Taylor that cost causation, or any other principle based on good economics  
33 or common sense, requires the Authority to view calls to an ISP as  
34 anything other than a local call.

---

<sup>1</sup> Direct Testimony of Alphonso J. Varner on behalf of BellSouth Telecommunications, Inc., page 3.

1  
2 **Q. Before you explain your position on each of the issues above, can you first**  
3 **summarize your response to BellSouth's position that ICG should pay**  
4 **BellSouth for carrying BellSouth's customers' ISP bound traffic?**

5 A. BellSouth's argument is without merit. Using orders from the FCC that are nearly  
6 20 years old, and a switched access charge regime that is currently being  
7 overhauled by the FCC under the notion that it is out of touch with the reality of  
8 today's network costs, BellSouth has attempted to structure an argument where  
9 CLECs actually pay BellSouth to carry its traffic. BellSouth's position is an  
10 obvious attempt to shift the Authority's attention away from the proper cost  
11 recovery mechanisms required to ensure that carriers like ICG are compensated  
12 for carrying traffic generated by BellSouth's end users. At its heart, BellSouth's  
13 position makes obvious the fact that while it continues to sell enormous amounts  
14 of second access lines and generally does everything it can to reap windfall profits  
15 from its customers' Internet usage, it is unwilling to pay the carriers that end up  
16 carrying the brunt of its end users' traffic – the ICGs of the marketplace (i.e.,  
17 CLECs). Not only is BellSouth unwilling to pay these carriers for carrying the  
18 traffic generated by its expanding customer base (from which it profits greatly), it  
19 now, in Mr. Varner's and Dr. Taylor's testimony in this case, is attempting to  
20 charge those carriers for the privilege of carrying its customers' traffic.

21 BellSouth's plan must be dismissed *in toto* before the Authority can address the  
22 issue of reciprocal compensation for ISP bound traffic in a manner consistent with  
23 good economics, good public policy and good common sense. I discuss at greater  
24 length, later in my testimony, why on every front BellSouth's argument in support  
25 of its "switched access sharing" proposal is inaccurate and inappropriate.  
26

1 **Q. Can you reiterate ICG's position regarding the issue of proper payment for**  
2 **traffic originated on the network of one interconnecting LEC and passed to**  
3 **an ISP served by the other interconnecting LEC?**

4 A. It is ICG's position that sound economic and public policy rationales require that  
5 a carrier be compensated for its costs incurred when other carriers use its network  
6 for purposes of delivering their originating customers' traffic. BellSouth's  
7 customers use ICG's network whenever they dial an ICG customer, regardless of  
8 whether that customer is a residential customer or an ISP. BellSouth's use of  
9 ICG's network generates costs that ICG must recover, just as ICG's use of the  
10 BellSouth network generates costs for which ICG is willing to compensate  
11 BellSouth. As I fully explain in my direct testimony, the costs generated by a call  
12 bound for an ISP customer do not differ from those generated by calls bound for  
13 other types of ICG customers. Hence, BellSouth should be required to  
14 compensate ICG for its use of ICG's network regardless of whether the call is  
15 bound for an ISP or any other type of local customer. Because calls to an ISP are  
16 identical to local calls, the reciprocal compensation rate applicable to local traffic  
17 is the best cost-based rate available for purposes of establishing reasonable  
18 compensation for ISP-bound traffic.

19  
20 **Q. Do you agree with BellSouth's position that reciprocal compensation rates**  
21 **are not applicable to ISP bound traffic?**

22 A. No, I do not. It is clear from reading the FCC's *Declaratory Ruling in C.C.*  
23 *Docket No. 96-98 and Notice of Proposed Rulemaking in CC Docket No. 96-98*  
24 *(hereafter "Declaratory Ruling")*, that while the FCC made a number of critical  
25 decisions impacting compensation for ISP bound traffic, the FCC left to the states  
26 an enormous responsibility to determine the proper compensation that carriers  
27 should receive for this traffic until a national rule is established. The following

excerpt from paragraph 26 of the FCC's *Declaratory Ruling* best frames a state commission's responsibility in this regard:

Although reciprocal compensation is mandated under Section 251(b)(5) only for the transport and termination of local traffic, neither the statute nor our rules prohibit a state commission from concluding in an arbitration that reciprocal compensation is appropriate in certain instances not addressed by section 251(b)(5), so long as there is no conflict with governing federal law. A state commission's decision to impose reciprocal compensation obligations in an arbitration proceeding – or a subsequent state commission decision that those obligations encompass ISP-bound traffic – does not conflict with any Commission rule regarding ISP-bound traffic. By the same token, in the absence of governing federal law, state commissions also are free not to require the payment of reciprocal compensation for this traffic and to adopt another compensation mechanism. [footnotes omitted, emphasis added]

**Q. Why did you highlight the last sentence of the quote above?**

**A.** I think there is an important point the FCC is making in the last sentence that it reiterates more directly in paragraph 29:

We acknowledge that, no matter what the payment arrangement, LECs incur a cost when delivering traffic to an ISP that originates on another LEC's network.

It seems clear from these two paragraphs that while a state commission is "...free not to require the payment of reciprocal compensation for this traffic...", if it chooses this path it must "adopt another compensation mechanism" to recognize the fact that LECs incur costs when delivering traffic to an ISP. It appears clear that the FCC does not sanction simply ignoring the issue.

**Q. Hasn't the FCC specifically held that ISP-bound traffic is generally interstate in nature, that reciprocal compensation is applicable only to local traffic, and**



1        **hence, that the reciprocal compensation requirements of Section 251(b)(5) of**  
2        **the Act do not govern inter-carrier compensation for this traffic?**

3    A.    Generally, it has. However, the issue of determining the appropriate level of  
4        compensation for ISP bound traffic isn't simplified by this finding. Throughout  
5        its *Declaratory Ruling* the FCC makes it clear that in the past it has treated ISP  
6        bound traffic as local in nature and encourages state commissions to establish  
7        compensation mechanisms based upon this assumption in the future.

8  
9    **Q.    If the FCC has made this determination, how can you suggest that reciprocal**  
10       **compensation rates may still be applicable to ISP-bound traffic?**

11   A.    The FCC has obviously left the state commissions to determine an appropriate  
12        rate of compensation one LEC should pay another for ISP-bound traffic. It  
13        appears that it has given the state commissions an option to either adopt the  
14        reciprocal compensation rates that they have adopted as reasonable payment for  
15        all other types of local traffic, or to construct another means of compensation  
16        specific to ISP-bound traffic. Hence, even if ISP-bound traffic doesn't meet the  
17        legal definition of "local traffic," the FCC has given a strong indication that  
18        reciprocal compensation rates are a good place to start when determining  
19        reasonable rates for ISP-bound traffic. Indeed, the FCC goes so far at paragraph  
20        23 of the *Declaratory Ruling* as to say that it has consistently in the past treated  
21        ISP-bound traffic "...as if it were local." This is part and parcel of the FCC's  
22        encouragement to states that they adopt reciprocal compensation rates as  
23        reasonable rates for purposes of compensating carriers for carrying ISP-bound  
24        traffic – regardless of the jurisdiction of that traffic.

25  
26   **Q.    Have other state commissions made decisions in this respect since the FCC**  
27       **issued its Declaratory Ruling?**

1 A. Yes, since the FCC's issuance of its Declaratory Ruling, at least 15 states have  
2 issued decisions concluding that carriers are entitled to reciprocal compensation  
3 for delivery of ISP-bound traffic. Amongst those that have interpreted the FCC's  
4 Declaratory Ruling for purposes of governing interconnection agreements within  
5 their intra-state jurisdictions is the Maryland Public Service Commission. In my  
6 opinion, the Maryland Commission provides the most reasoned reading to date of  
7 the FCC's intentions. In *Order No. 75280* at pages 16 and 17 the Maryland  
8 Commission finds as follows:

9  
10 Thus, under the FCC's *ISP Order*, it is incumbent upon the Authority to determine  
11 an interim cost recovery methodology which may be used until the FCC completes  
12 its rulemaking on this issue and adopts a federal rule governing inter-carrier  
13 compensation arrangements.

14  
15 In fact, according to the FCC, "State commissions are free to require  
16 reciprocal compensation for ISP-bound calls, or not require reciprocal  
17 compensation and **adopt another compensation mechanism**, bearing in  
18 mind that ISP/ESPs are exempt from paying access charges." This directive  
19 does not leave us the option of providing for no compensation for ISP-bound  
20 calls. State commissions must either require reciprocal compensation or  
21 develop another compensation mechanism. To fail to provide for any  
22 compensation would violate the 1996 Act, which states:

23  
24 *A State commission shall not consider the terms and*  
25 *conditions for reciprocal compensation to be just*  
26 *and reasonable unless such terms and conditions*  
27 *provide for the mutual and reciprocal recovery by*  
28 *each carrier of costs associated with the transport*  
29 *and termination on each carrier's network facilities*  
30 *of calls that originate on the network facilities of*  
31 *the other carrier. 47 USC § 252(d)(2)(A).*  
32

33 We are very concerned that the adoption of BA-MD'S position will result  
34 in CLECs receiving no compensation for terminating ISP-bound traffic.  
35 Such an effect will be detrimental to our efforts to encourage competition  
36 in Maryland. No one disputes that local exchange carriers incur costs to  
37 terminate the traffic of other carriers over their network. In the absence of

finding that reciprocal compensation applies, a class of calls (ISP traffic) will exist for which there is no compensation. The reciprocal compensation rates established by our arbitration order and contained in the approved Statement of Generally Available Terms ("SGAT") reflect the costs of this termination. Until the FCC establishes an appropriate inter-carrier compensation mechanism for ISP-bound traffic, we find that it is in the public interest to require BA-MD to pay our arbitrated reciprocal compensation rates contained in the SGAT as an **interim** compensation mechanism. [footnotes omitted, emphasis in original]

**Q. Mr. Varner and Dr. Taylor mention 3 states that have decided that carriers should not compensate one another for ISP bound traffic at reciprocal compensation rates. Do you have any comments regarding their testimony in this regard?**

A. Yes, I do. First, Mr. Varner and Dr. Taylor in their respective testimonies identify 3 states that arguably support their position with respect to compensation for ISP-bound traffic.<sup>2</sup> They fail to describe, however, that at least 15 other state commission decisions rejected many of the exact same arguments BellSouth proffered in this proceeding before ultimately finding that compensation, at reciprocal compensation rates, is reasonable and lawful for ISP-bound traffic.

**Q. Mr. Varner suggests in his testimony that "Compensation for ISP bound traffic is not subject to a Section 252 arbitration." Do you agree?**

A. No, I do not agree and neither does the FCC. In footnote 87, found in paragraph 26 of the FCC's *Declaratory Ruling*, the FCC states as follows:

As discussed, *supra*, in the absence of a federal rule, state commissions have the authority under section 252 of the Act to determine inter-carrier compensation for ISP-bound traffic.

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<sup>2</sup> See the discussion of the South Carolina order included in Ms. Schonhaut's testimony for purposes of understanding why even the three decisions quoted by Mr. Varner and Dr. Taylor don't necessarily support BellSouth's position in this case before the Authority.

1  
2 Moreover, in its *Notice of Proposed Rulemaking* included as a portion of its  
3 *Declaratory Ruling*, the FCC tentatively concludes that even as a result of the  
4 federal policy it ultimately adopts in a federal rule, states should still play the role  
5 of setting inter-carrier compensation rates for ISP-bound traffic:

6  
7 30. We tentatively conclude that, as a matter of federal policy, the inter-  
8 carrier compensation for this interstate telecommunications traffic [ISP-  
9 bound traffic] should be governed prospectively by interconnection  
10 agreements negotiated and arbitrated under sections 251 and 252 of the  
11 Act. Resolution of failures to reach agreement on inter-carrier  
12 compensation for interstate ISP-bound traffic then would occur through  
13 arbitrations conducted by state commissions, which are appealable to  
14 federal district courts.  
15

16 **Q. Mr. Varner believes that reciprocal compensation for ISP-bound traffic is**  
17 **inconsistent with sound public policy. Do you agree?**

18 A. No, I do not. In my direct testimony, I explained at length why sound economic  
19 and public policy rationales support payment for ISP-bound traffic originating on  
20 the network of one local carrier and passed to the network of another. I won't  
21 duplicate my arguments here. However, in my response to Dr. Taylor, included  
22 later in this testimony, I provide further basis for the fact that good public policy  
23 and sound economic principles require the Authority to reject BellSouth's  
24 proposal and find that ICG must be allowed to recover from BellSouth costs it  
25 incurs for carrying BellSouth's traffic.  
26

27 **Q. Mr. Varner includes at page 7 of his Direct Testimony three specific options**  
28 **the Authority could follow in resolving the dispute surrounding**  
29 **compensation for ISP bound traffic. Do you agree with any of Mr. Varner's**  
30 **recommendations?**

1 A. No, I do not. Each of Mr. Varner's three options ignores the fact that ICG is  
2 today carrying large amounts of traffic generated by BellSouth's local customers  
3 without any compensation. As such, each of Mr. Varner's proposals is  
4 inconsistent with sound economics, good public policy and the FCC's  
5 encouragement that carriers be allowed to recover their costs from the parties  
6 causing those costs.  
7

8 **BELLSOUTH OPTION 1**  
9

10 **Q. Please discuss Mr. Varner's first proposal.**

11 A. Mr. Varner's first proposal would require carriers to track the ISP-bound traffic at  
12 issue, establish no compensation for that traffic at this point in time, but allow for  
13 a "true-up" whenever a "non-appealable order of the FCC" becomes available.  
14 There are several problems with this approach. First, ICG is incurring costs for  
15 carrying BellSouth's traffic now. While BellSouth, as an enormous multi-  
16 national firm, may be able to forego cost recovery for long periods of time  
17 without adverse financial consequences, ICG is not equally positioned.  
18

19 Second, there is no established time frame by which the FCC, which is currently  
20 swamped with a myriad of other issues, will adopt an order in this regard.

21 Likewise, by including the position that only a "non-appealable" order would  
22 suffice to allow for compensation, it is clear that BellSouth could follow its  
23 common practice of appealing an FCC order that wasn't consistent with its liking  
24 thereby further extending the amount of time before compensation is paid. All the  
25 while, ICG continues to carry BellSouth's traffic without compensation.  
26

1 Further still, it is possible, even likely given the FCC's comments in the Further  
2 Notice of Proposed Rulemaking (NPRM) section of its Declaratory Ruling, that  
3 the FCC may relegate a final decision to state commissions. As such, under  
4 BellSouth's proposal, not only would ICG need to wait until after a "non-  
5 appealable" order from the FCC is available, it may also have to await another  
6 state proceeding resulting from the FCC's relegation of the issue before it can  
7 expect to be paid. This could take some significant period of time, within which,  
8 ICG is not being paid for carrying BellSouth traffic. This simply is not an  
9 equitable solution given the financial investment that will be required of a newer,  
10 smaller carrier like ICG during this time frame. It is clear that some interim form  
11 of compensation is necessary.  
12

13 **BELLSOUTH OPTION II**  
14

15 **Q. Please describe BellSouth's second option.**

16 A. BellSouth's second option would require a carrier who serves an ISP to allocate a  
17 portion of the ISP's local service revenue to be shared with the carrier whose local  
18 service customers call that ISP. In effect, under BellSouth's second option, ICG  
19 would be required to pay BellSouth for carrying the traffic generated by its local  
20 service customers.  
21

22 **Q. Do you agree with Mr. Varner's second option?**

23 A. No, I do not. This argument is part and parcel of BellSouth's position that  
24 switched access charges should apply to traffic passed to ISP customers and that  
25 the switched access charge regime is the proper framework within which to view

1 ISP traffic and its proper compensation.<sup>3</sup> Within the switched access charge  
2 regime, long distance carriers compensate local exchange carriers both to  
3 originate and terminate calls placed over their networks. Unlike the switched  
4 access regime, reciprocal compensation obligates the local exchange carrier  
5 originating the call to compensate the carrier terminating the call for carrying the  
6 traffic on its network. The switched access charge regime is an old model that is  
7 currently being challenged in every state and is being revised substantially by the  
8 FCC. While it is advantageous for BellSouth to lump as much traffic as it can  
9 into the switched access pot (because that pot is simply a slush fund of revenues  
10 that recover amounts magnitudes greater than any costs that are actually incurred),  
11 I do not agree that the switched access framework is an appropriate framework  
12 within which to view ISP-bound traffic. The FCC and a growing number of states  
13 have found the switched access framework to be significantly out-of-line with  
14 cost causation and badly in need of repair.

15  
16 Even without a recognition that the switched access charge structure is out of date  
17 and overpriced, as I describe in more detail later, calls to an ISP customer do not  
18 resemble switched access traffic, they are not purchased as switched access traffic  
19 and the FCC has already found that switched access charges do not apply to such  
20 traffic. Hence, it is important that the Authority decide that the reciprocal  
21 compensation rate paid for local traffic is also applicable to ISP-bound traffic.

22  
23 **Q. In support of its second option, BellSouth contends that the FCC has for over**  
24 **30 years regulated data carriers as interstate carriers and has held that while**

---

<sup>3</sup> See BellSouth's *Comments* to the FCC in C.C. Docket No. 99-68, pages 8-9, as well as Mr. Varner's testimony at page 11.

1       these carriers are being provided access services, they are allowed to collect  
2       traffic at the prices for business services. Can you comment?

3    A.   Regardless of how the FCC has regulated "data carriers," ISPs, to the extent they  
4       compare to the "data carriers" to which BellSouth refers, are not purchasing or  
5       being provided interstate access services when they purchase connection to the  
6       public switched network.

7  
8       The FCC has held, in an order far more recent than 30 years old, that Enhanced  
9       Service Providers (ESPs), a larger group within which ISPs generally fall, are  
10      providing *interstate* service, not access or toll services, and that they purchase  
11      their connections to the public switched network via local business tariffs.<sup>4</sup>  
12      Indeed, the FCC has provided an exemption such that ISPs are not required to pay  
13      switched access charges that would normally be assessed. BellSouth concludes  
14      from this information that ISP-bound traffic is subject to switched access charges,  
15      yet, the FCC has simply suspended the requirement that ISPs pay these charges  
16      pursuant to an access charge exemption. Indeed, BellSouth goes so far as to  
17      suggest that the rates ISPs pay local carriers like ICG are actually access charges  
18      assessed on a per month, instead of a per minute basis. As such, local carriers like  
19      ICG should be responsible for sharing those monthly access charges with  
20      BellSouth in compliance with industry standard access sharing arrangements.<sup>5</sup>  
21      This analysis is tortured and self-serving.

22  
23    Q.   Please explain in greater detail why you disagree that ICG should share  
24       revenues received from an ISP with BellSouth.

---

<sup>4</sup> Declaratory Ruling, paragraphs 9, 20, 23 and 36.

<sup>5</sup> Carriers often share switched and special access revenues through "meet point billing" arrangements wherein the percentage ownership of facilities required to provision the service is determined and the access charge revenues are divided amongst the carriers based on this percentage.



1   A.     First, the revenue ICG, or any other local exchange carrier, receives from an ISP  
2         is not switched or special access revenue charged on a monthly instead of a per  
3         minute of use basis. The FCC has stated on numerous occasions that ISPs are  
4         allowed to obtain access to the public switched network using intrastate, local  
5         exchange tariffs and that is exactly what they buy and pay for.<sup>6</sup> The fact that these  
6         intrastate local exchange services may supplant some type of switched access  
7         service for which BellSouth would prefer to charge, does not render these services  
8         as access services or make their revenues available for sharing under some type of  
9         switched access, meet-point billing arrangement.

10  
11         Second, the FCC in its Declaratory Ruling makes clear that the proper framework  
12         within which to view compensation for ISP-bound traffic is the reciprocal  
13         compensation framework wherein the carrier originating a call is responsible for  
14         the costs of carrying the call.<sup>7</sup> Therefore, it seems clear that the FCC does not  
15         agree that compensation for ISP-bound traffic should be subject to the switched  
16         access framework or that ICG should be required to share local revenues garnered  
17         from ISP customers with BellSouth.

18  
19         Third, switched access charges are assessed on toll traffic generated by a local  
20         exchange carrier's customer and passed to an interexchange carrier. The traffic at  
21         issue here, traffic to an ISP, is not toll traffic. The end user customer dialing the  
22         call is not assessed toll charges, the ISP to which the traffic is ultimately passed is

---

<sup>6</sup> *Declaratory Ruling*, paragraph 20.

<sup>7</sup> *Declaratory Ruling*, paragraph 30. The FCC states: "We tentatively conclude that, as a matter of federal policy, the inter-carrier compensation for this interstate telecommunications traffic should be governed prospectively by interconnection agreements negotiated and arbitrated under sections 251 and 252 of the Act." Switched access services are not part and parcel of section 251 and 252 as held by the FCC in its *First Report and Order* in C.C. Docket No. 96-98, hence, it is clear that the FCC considers reciprocal compensation requirements, as exclusively included in sections 252 and 252 of the Act, as the model by which "this (i.e., ISP-bound traffic) interstate telecommunications traffic should be governed...."

1 not purchasing switched access service, and perhaps most importantly, none of the  
2 revenues generated by either the ILEC or the CLEC can be considered toll or  
3 access revenue. Hence, despite BellSouth's arguments, there is little if any  
4 relationship between traffic bound for an ISP customer and traffic bound for an  
5 IXC. All technical, economic and regulatory comparisons between local traffic,  
6 ISP traffic and long distance/access traffic indicate that local traffic and ISP traffic  
7 share far more similarities than do ISP traffic and toll/access traffic.

8  
9 **Q. Can you explain in greater detail why none of the revenues generated by**  
10 **either the ILEC or the CLEC in a call to an ISP can be considered toll or**  
11 **access revenue?**

12 **A.** The FCC has specifically held that revenues and costs generated by traffic to an  
13 ISP must be considered to be intrastate, not interstate, traffic. In fact, both SBC  
14 and Bell Atlantic have attempted to reclassify costs and revenues from traffic to  
15 an ISP provider as interstate traffic and on both occasions, the FCC has rejected  
16 their filing. In the most recent attempt made by Bell Atlantic in this regard the  
17 FCC's Common Carrier Bureau had the following to say:<sup>8</sup>

18  
19 As I recently explained to SBC Communications, the Authority requires  
20 carriers to classify the costs and revenues associated with ISP-bound  
21 traffic as intrastate for jurisdictional separations and reporting purposes.

22  
23 It is interesting to note that Mr. Strickling, the Chief of the FCC's common  
24 Carrier Bureau and the author of the Authority's letter to Bell Atlantic, cited the

---

<sup>8</sup> July 29, 1999 Letter from Lawrence E. Strickling, Chief, Common Carrier Bureau to Don Evans, Vice President – Regulatory Affairs, Bell Atlantic.

1 FCC's *Declaratory Ruling* as the authority for requiring Bell Atlantic to classify  
2 its ISP bound traffic as intrastate traffic.

3  
4 The FCC's declaratory ruling states as follows (paragraph 9):

5  
6 As explained above, under the ESP exemption, LECs may not impose  
7 access charges on ISPs; therefore, there are no access revenues for  
8 interconnecting carriers to share. Moreover, the Commission has directed  
9 states to treat ISP traffic as if it were local, by permitting ISPs to purchase  
10 their PSTN links through local business tariffs.  
11

12 **Q. If all technical, economic and regulatory comparisons indicate that traffic**  
13 **bound for ISP providers more closely resembles local traffic as opposed to**  
14 **switched access traffic, on what basis does BellSouth contend that this traffic**  
15 **is switched access traffic for which reciprocal compensation is not required?**

16 A. BellSouth's entire rationale for refusing to pay reciprocal compensation for ISP  
17 bound traffic is based upon a legal/jurisdictional argument, i.e., that ISP bound  
18 traffic is interstate, not local, traffic. It is not based upon sound public policy.  
19 Certainly sound economic and public policy must recognize that when a carrier  
20 uses another carrier's network and costs result, the carrier upon whose network  
21 the call originates (the true cost causer) must be responsible for compensating the  
22 other carrier for the costs it incurs. BellSouth's position has no basis in sound  
23 economic or public policy rationale and as such, is nothing more than a legalistic  
24 strawman.  
25

26 **Q. Even if it were appropriate to discard sound economic and public policy**  
27 **rationale, do you agree with BellSouth's argument?**

28 A. I don't agree with BellSouth's position. I've discussed the jurisdictional nature of  
29 ISP-bound traffic and the extent to which the FCC has placed responsibilities on

1 state commissions for determining an appropriate compensation mechanism  
2 earlier in my testimony. My intention is not to restate those arguments here  
3 though I believe they do provide relevant information in contradicting BellSouth's  
4 argument. My response above is simply meant to make one point. BellSouth's  
5 position regarding the payment of reciprocal compensation is based solely upon  
6 jurisdictional/legal argumentation. BellSouth's position should not be mistaken  
7 to promote the public interest or to further sound economic policy. In fact,  
8 BellSouth's position is in direct conflict with the cost-based compensation  
9 mechanism upon which the TA96 and the FCC's Local Competition Order are so  
10 appropriately based.

11  
12 **Q. Has BellSouth always maintained the argument that ISP-bound traffic is not**  
13 **local?**

14 A. No. In a press release dated March 12, 1997, hailing a strategic agreement  
15 between BellSouth and IBM which would provide a comprehensive set of  
16 Internet/Intranet services to customers in the Southeast, John Robinson, president  
17 of BellSouth.net, Inc. said,

18  
19 By connecting to the Internet through the IBM Global Network, BellSouth  
20 customers will get an important benefit – the ability to access the Internet  
21 from more than 830 locations in 49 counties with just a local call.  
22 [emphasis added]<sup>9</sup>  
23

24 As I mentioned above, when marketing the Internet to its own customers  
25 BellSouth makes every effort to make access the Internet as easy as possible.  
26 Indeed, in the excerpt above, BellSouth is not only admitting that a call made to

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<sup>9</sup> BellSouth.net Website.

1 its wholly owned ISP (BellSouth.net) is a local call, it is marketing this fact as a  
2 major advantage of BellSouth.net.

3  
4 **BELLSOUTH OPTION III**

5  
6 **Q. Please respond to Mr. Varner's third proposal wherein the Authority would**  
7 **require a "bill and keep" arrangement between the parties.**

8 A. My first reaction to Mr. Varner's proposal is that this is a new proposal on the part  
9 of BellSouth. Though ICG has now completed the hearing phase of its  
10 arbitrations with BellSouth in North Carolina, Alabama and Florida, this is the  
11 first time, to my knowledge, that BellSouth has ever suggested that bill and keep  
12 would be an effective method by which to resolve this issue.<sup>10</sup> More importantly,  
13 however, Mr. Varner's recommendation for a "bill and keep" arrangement is  
14 inconsistent with the FCC's rules and with BellSouth's previous positions.

15  
16 **Q. Why do you believe Mr. Varner's recommendation for a "bill and keep"**  
17 **arrangement is inconsistent with the FCC's rules?**

18 A. First, bill and keep, as recognized by the FCC in rule § 51.713 is a reasonable  
19 arrangement only if the traffic exchanged between the two carriers is balanced.  
20 Indeed, FCC rule §51.713 requires a state that chooses to impose a bill and keep  
21 arrangement to find that the traffic between the two carriers in question is  
22 balanced:

23 **§ 51.713 Bill-and-keep arrangements for reciprocal compensation**  
24

25 (b) A state commission may impose bill-and-keep arrangements if the  
26 state commission determines that the amount of local telecommunications

---

<sup>10</sup> To my knowledge BellSouth has also failed to proffer this option in the ITC^DeltaCom arbitrations which are occurring concurrently with the ICG arbitrations in many states. For example, I don't believe BellSouth has proffered this position in either South Carolina or Louisiana.

1 traffic from one network to the other is roughly balanced with the amount  
2 of local telecommunications traffic flowing in the opposite direction, and  
3 is expected to remain so, and no showing has been made pursuant to §  
4 51.711(b) of this part.  
5

6 Clearly, BellSouth has provided no evidence in this proceeding that would allow  
7 the Authority to find that ISP-bound traffic passed between itself and ICG is  
8 balanced. And, as I explained in my Direct Testimony, because ICG and other  
9 CLECs have been notably successful in winning ISP providers as customers, it is  
10 unlikely that the traffic between BellSouth and ICG is balanced. As such, a bill-  
11 and-keep arrangement would not be efficient, equitable or allowed by FCC rule  
12 §51.713.  
13

14 **Q. Why do you believe BellSouth's proposal to adopt a bill-and-keep**  
15 **arrangement is inconsistent with its previous position?**

16 **A.** Simply put, BellSouth's policies regarding the appropriate application of bill-and-  
17 keep arrangements appear to have changed by 180° since realizing that it might, in  
18 some circumstances, actually be required to pay, instead of only receive,  
19 reciprocal compensation payments. The following question and answer is taken  
20 from BellSouth witness Scheye's testimony before the Authority in Docket No.  
21 96-01152.<sup>11</sup>  
22

23 **Q. DOES BELL SOUTH AGREE WITH AT&T'S POSITION**  
24 **THAT BILL AND KEEP SHOULD BE IMPLEMENTED AS A**  
25 **COMPENSATION MECHANISM FOR LOCAL**  
26 **INTERCONNECTION?**  
27

28 **A.** First and most fundamentally, it is my understanding that  
29 mandatory bill and keep violates Section 252 of the Act. The Act

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<sup>11</sup> Direct Testimony of Robert C. Scheye, Docket No. 96-01152, October 11, 1996, see pages 24 and 25.

1 clearly allows negotiating parties to relinquish the mutual recovery  
2 of costs voluntarily should they so desire and enter voluntarily into  
3 bill and keep arrangements. The Act does not authorize a state  
4 commission to mandate that a party accept bill and keep as the  
5 method of cost recovery.  
6

7 Second, with this arrangement there is no mechanism for the  
8 recovery of costs associated with the termination of local calls.  
9 For example, if it costs BellSouth three cents per minute to  
10 terminate a local call and it costs a new entrant five cents a minute  
11 to terminate a local call, this arrangement will not allow either  
12 party to recover its costs. At best, in the situation illustrated, if the  
13 traffic were perfectly balanced, the carrier with the lower cost  
14 might be able to conclude that it was somehow okay because the  
15 payments it avoided making to the other carrier exceeded its own  
16 costs. Using the numbers above, however, the new entrant would  
17 be unable to recover the net difference of two cents per minute  
18 under any theory. This problem could be accentuated if there is a  
19 traffic imbalance.  
20

21 Third, a compensation arrangement of this type prevents BellSouth  
22 from being compensated for access to, and use of, its valuable  
23 network. Also, it does not recognize different types of technical  
24 interconnection arrangements that may exist. Because there will be  
25 varying interconnection arrangements, there must be a way to  
26 differentiate the charges based upon these differences. Under bill  
27 and keep, there would be no way to differentiate the charges and  
28 this would discourage the development of efficient networks by the  
29 new entrants. New entrants would simply take advantage of the  
30 functionalities in BellSouth's network, having no incentive to build  
31 their own capabilities because they could obtain them for free from  
32 BellSouth.  
33

34 Fourth, the distinction between local and toll calls can no longer be  
35 assured. The industry must move to a common interconnection  
36 structure. Bill and keep cannot serve that function. Adoption of  
37 bill and keep will undermine long distance competition as well as  
38 local competition.  
39

40 Finally, bill and keep establishes an inappropriate arrangement  
41 between competing carriers. Bill and keep is similar to a barter

arrangement, which is not a typical method used for compensating businesses for services provided.

Mr. Scheye makes a number of important points in his testimony above. Most importantly, however, Mr. Scheye (and apparently BellSouth at some point in the past) recognized that bill and keep does not compensate a carrier for its costs associated with carrying another carrier's traffic even in some circumstances where traffic may be perfectly balanced, much less when the traffic is heavily imbalanced, as is the case with traffic exchanged by ICG and BellSouth.

**Q. Mr. Varner at page 33 of his Direct Testimony includes a table which he believes describes the market distorting effects of reciprocal compensation payments made for ISP-bound traffic. Do you agree with Mr. Varner's analysis?**

**A. No. I do not. Mr. Varner at page 33 of his testimony includes the following chart:**

	<i>SERVING AN ISP AND RECEIVING RECIPROCAL COMPENSATIO N</i>	<i>SERVING AN ISP WITHOUT RECEIVING RECIPROCAL COMPENSATIO N</i>
REVENUE FROM ISP FOR SERVICE	\$600	\$900
RECIPROCAL COMPENSATION REVENUE PAID	\$300	\$0
COST OF PROVIDING SERVICE TO ISP	(\$600)	(\$600)
NET MARGIN	\$300	\$300



1 In my direct testimony I argued that the absence of reciprocal compensation  
2 payments would distort the marketplace. Mr. Varner attempts to use the table  
3 above to show that reciprocal compensation paid for ISP bound traffic is actually  
4 the culprit responsible for distorting the competitive marketplace. However,  
5 properly viewed, Mr. Varner's table actually undermines his point and supports  
6 mine.

7  
8 **Q. Why do you believe the above table shows that the absence of reciprocal**  
9 **compensation payments for ISP bound traffic would distort the**  
10 **marketplace?**

11 **A.** The table above makes a number of assumptions: (1) that it costs a CLEC \$300 to  
12 carry traffic originated on the ILECs network to the ISP, (2) that it costs a CLEC  
13 \$600 to provide an access line to an ISP, and (3) that the CLEC receives a \$300  
14 margin. Using these assumptions, let's review two scenarios: (1) the  
15 Commission requires BellSouth to compensate ICG for delivering BellSouth's  
16 customers' traffic to ICG ISPs, and (2) the Commission decides to not require  
17 reciprocal compensation for such ISP bound traffic.

18  
19 Under scenario 1, ICG would receive \$600 from its ISP customer for an access  
20 line allowing the ISP to connect to the network. Likewise, it would receive \$300  
21 from BellSouth for carrying traffic originated from BellSouth customers to the  
22 ISP (a total of \$900 in revenue). All told, the CLEC would incur \$600 in costs  
23 (\$300 for provisioning the access line and \$300 for carrying BellSouth's traffic)  
24 and receive \$900 in revenue while charging its ISP customer \$600. If the  
25 Commission were to decide not to require BellSouth to pay for ICG's carriage of  
26 its traffic, scenario number (2) would look much different.

Under scenario number 2, ICG would receive \$0 from BellSouth for carrying its traffic. Regardless, it would still incur both its own \$300 in cost for providing an access line to the ISP and it would continue to incur \$300 in costs associated with carrying BellSouth's traffic. Hence, in order to maintain its \$300 net margin, ICG would be required to charge \$900 to its ISP instead of the \$600 it charged earlier.

You need only compare scenario 2 above with a scenario wherein the ICG customer in question is a large business user instead of an ISP to appreciate the market distortion. The following table compares a scenario very much like Mr. Varner's, except that it compares a business customer and an ISP customer served by ICG and assumes reciprocal compensation payments for ISP bound traffic are not required:

	<i><b>SERVING A BUSINESS CUSTOMER WITH LARGE INBOUND CALLING PATTERNS</b></i>	<i><b>SERVING AN ISP</b></i>
REVENUE FROM ACCESS LINE SERVICE	\$600	\$900
RECIPROCAL COMPENSATION REVENUE PAID	\$300	\$0
COST OF PROVIDING SERVICE	(\$600)	(\$600)
NET MARGIN	\$300	\$300

Because BellSouth agrees that calls to ICG business users are subject to reciprocal compensation, it would reimburse ICG for the \$300 in costs associated with

1 carrying its traffic. Hence, serving a large business user would look very much  
2 like scenario number 1 above, in which ICG was required to charge only \$600 for  
3 a network access line to serve the customer. In the marketplace under scenario 2,  
4 however, assuming the Commission allowed BellSouth to avoid reimbursing ICG  
5 for carrying its traffic, ICG could offer the exact same business line to a business  
6 customer at \$600 that it must offer to an ISP at \$900 to receive the same net  
7 margin. Or, looking at it another way, ICG could charge \$600 to a business  
8 customer for an access line and receive \$300 in net margin while offering the  
9 same access line to an ISP for \$600 and receiving \$0 in net margin. It is easy to  
10 see that under such a scenario, ISPs would become less attractive than any  
11 customer for which reciprocal compensation would be paid. Further, it is likely  
12 rates to ISPs would go up or carriers serving large numbers of ISPs would find  
13 themselves with a large population of unprofitable customers.  
14

15 **Q. How would this situation be affected by BellSouth's proposal that ICG pay**  
16 **BellSouth for originating calls to its ISP customers?**

17 A. This aspect further reveals the ludicrous nature of BellSouth's proposition. If ICG  
18 were required to pay BellSouth for carrying large amounts of BellSouth's traffic  
19 to its ISP customers, ISPs would not be merely unprofitable (i.e., generating \$0 in  
20 net margin); they would be a financial burden. Under such a circumstance, ICG  
21 would be providing a great service to BellSouth's customers (i.e., carrying traffic  
22 bound for the Internet) and incurring substantial costs to do so, while at the same  
23 time being required to pay BellSouth for the "opportunity." It simply doesn't  
24 make any sense.  
25

26 **Q. Would such a situation benefit BellSouth?**

1 A. Undoubtedly. Such a circumstance would greatly benefit BellSouth at the  
2 expense of the CLECs and the marketplace. This is exactly the point I made in  
3 my direct testimony. When the Commission attempts to understand BellSouth's  
4 underlying rationale for its somewhat bizarre recommendation regarding  
5 reciprocal compensation, it should keep in mind the likely results of adopting such  
6 a recommendation. In a world where CLECs are required to pay BellSouth for  
7 delivering BellSouth's customers' Internet traffic, ISPs will undoubtedly pay  
8 higher rates for the same services offered to other businesses and they are likely to  
9 simply become far less attractive. As a result, fewer and fewer carriers would  
10 attempt to serve them. In general, life becomes hard as an ISP. However, there is  
11 a class of ISPs in the market that would be somewhat insulated from this effect.  
12 Any ISP that had an affiliation with a local exchange carrier and provided services  
13 primarily to customers served by the local exchange carrier, would create a  
14 situation wherein the LEC rarely, if ever, was required "share" ISP revenues with  
15 another LEC. This lack of sharing would lower the costs of providing services to  
16 the ISP and would increase the profitability not only of the LEC serving the ISP,  
17 but also of the ISP itself. This type of ISP would be a powerful competitor  
18 against ISPs without such an "on-net" customer base. It could charge prices  
19 significantly below ISP competitors who were paying higher rates to CLECs  
20 while maintaining profitability. To illustrate, BellSouth would be such a  
21 competitor. Because BellSouth still maintains a near monopoly market position  
22 in the provision of services to residential and small business customers (the  
23 primary customer base responsible for dial-up Internet access), BellSouth.net  
24 would, under BellSouth's compensation proposal, rarely if ever need to share ISP  
25 revenues with other local carriers. Rarely would a CLEC customer dial into  
26 BellSouth.net (at least compared to the number of BellSouth customers calling  
27 non-BellSouth ISPs) such that BellSouth would be required to share revenues

1 with the local exchange carrier. In the vast majority of circumstances,  
2 BellSouth.net would serve BellSouth's local exchange customers so that  
3 BellSouth would receive all revenues.  
4

5 **Q. Is there any requirement that BellSouth.net serve all customers that request**  
6 **its service?**

7 A. I am not aware of any such requirement. However, it is not likely that  
8 BellSouth.net would turn customers away simply because they happen to obtain  
9 local service from another carrier. What is more likely is that BellSouth would  
10 attempt to provide better ISP prices and services to its own local exchange  
11 customers as opposed to local exchange customers of other carriers. In that way,  
12 BellSouth.net would be an attractive alternative only to BellSouth local customers  
13 and customers of other local carriers would unlikely subscribe to BellSouth.net.  
14 Not only is this likely, it happens today. BellSouth currently offers promotions  
15 that tie its local exchange services and its Internet services together at discounted  
16 rates. Indeed, it is my understanding that e.spire and the Competitive  
17 Telecommunications Association (Comptel) have filed a complaint with the  
18 Florida Commission highlighting BellSouth's marketing efforts in this regard.  
19

20 **Q. If BellSouth offered services to ISPs other than BellSouth.net, wouldn't this**  
21 **force BellSouth to share revenues with CLECs whose customers dialed those**  
22 **non-BellSouth affiliated ISPs?**

23 A. Yes, if BellSouth were to serve a non-BellSouth affiliated ISP that had no  
24 incentive to serve primarily BellSouth customers, it is likely BellSouth, under its  
25 own proposal, would be required to share the revenues associated with serving the  
26 ISP with other CLECs. However, I already highlighted in my direct testimony the  
27 fact that BellSouth has lost an enormous number of ISP providers (or new

1 providers have chosen never to obtain service from BellSouth). This results from  
2 the fact that CLECs provide those ISPs with more flexible service offerings and  
3 work directly with the ISPs to enhance their business. BellSouth, because of  
4 BellSouth.net, has no incentive to assist the ISPs in their business. Likewise, it  
5 has no incentive (indeed it has a disincentive) to provide those ISPs with quality  
6 services at reasonable rates. A primary example of BellSouth's unwillingness to  
7 accommodate the unique needs of ISPs is BellSouth's unwillingness to allow ISPs  
8 to collocate in its central offices. ISPs prefer to share the environmental  
9 controlled offices used by local exchange carriers to aggregate traffic. These  
10 offices provide efficient means by which to connect to the public switched  
11 network. Many CLECs allow the ISPs, just like they allow other large users, to  
12 use their central office space to house equipment. To this point, however,  
13 BellSouth has refused to allow similar access to its central offices. In this way,  
14 and simply by not meeting the needs of ISPs, BellSouth could, and would have an  
15 incentive to, dissuade non-BellSouth affiliated ISPs from using its services and  
16 thereby requiring that BellSouth share revenues with other CLECs.

17  
18 **Q. Did you review the testimony provided by Dr. Taylor on behalf of BellSouth?**

19 A. Yes, I did.

20  
21 **Q. Please summarize Dr. Taylor's testimony before responding to his**  
22 **arguments.**

23 A. Dr. Taylor's testimony is primarily intended, in my opinion, to support  
24 BellSouth's argument that it should be paid for allowing ICG to carry traffic its  
25 local customers generate. Dr. Taylor attempts to bolster this argument by using  
26 what he refers to as "the principle of cost causation." However, much like  
27 BellSouth's primary argument, Dr. Taylor's testimony has less to do with

economics than it has to do with jurisdictional and regulatory law. The majority of Dr. Taylor's testimony revolves around his comparison of two separate regulatory/jurisdictional constructs that could be used by the Authority to decide whether, and how, carriers should compensate one another for traffic bound for an ISP customer. Which model the Authority chooses, according to Dr. Taylor, will necessarily guide its decisions with respect to whether reciprocal compensation is due to the carrier serving the ISP (i.e., the CLEC in this circumstance), or, that compensation is due from the carrier serving the ISP to the carrier serving the customer originating the ISP call (i.e., to BellSouth from ICG).<sup>12</sup>

**Q. Please summarize Dr. Taylor's two conceptual constructs.**

A. The first construct, what Dr. Taylor refers to as the *ILEC-CLEC Interconnection Model*, relies, according to Dr. Taylor, on two primary assumptions:

1. The ILEC subscriber that calls the Internet is acting as a customer of the originating LEC, even when the call goes through the ISP to which it pays monthly access fees.
2. The ISP itself is an end-user (not a carrier) of the CLEC and the Internet call terminates at the ISP.<sup>13</sup>

The second construct, what Dr. Taylor refers to as the *ILEC-IXC Interconnection Model*, also relies, according to Dr. Taylor, on two primary assumptions:

1. The ILEC subscriber that calls the Internet is acting as a customer of the ISP to which it pays monthly access fees, even though the call is facilitated by the originating ILEC and the CLEC serving the ISP.

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<sup>12</sup> Direct Testimony of William H. Taylor, Ph.D., Docket No. 1999-259-C, August 35, 1999, pages 8-16.

<sup>13</sup> Id. page 8.

- 1  
2           2.     The ISP is viewed as a carrier – akin to an enhanced service  
3                 provider (“ESP”) – that routes the Internet call through the  
4                 backbone network to its final destination. The ISP performs the  
5                 standard carrier functions such as transport and routing, as well as  
6                 maintains leased facilities within the backbone network. It is  
7                 therefore not an end user of the CLEC.<sup>14</sup>  
8  
9

10       Dr. Taylor believes that the latter of these two examples is the proper regulatory  
11       and economic construct by which the Authority should view traffic bound for an  
12       ISP customer. He believes that the second construct supports BellSouth’s  
13       position that ICG should share revenues received from its ISP local users with  
14       BellSouth. In other words, because, in Dr. Taylor’s opinion, ISPs are really IXC’s,  
15       and the traffic they carry is actually toll traffic (delivered to them via switched  
16       access services provided by ICG), ICG should share those switched access  
17       revenues with BellSouth to compensate BellSouth for originating the call.  
18

19   **Q.     Is Dr. Taylor’s characterization of the ISP as a carrier – not an end-user –**  
20   **consistent with FCC rulings regarding the status of ISP carriers?**

21   A.     No. Dr. Taylor characterizes ISPs as carriers in his *ILEC-IXC Interconnection*  
22         *Model*, and Mr. Varner even represents that the FCC has treated ISPs as carriers  
23         for over 30 years.<sup>15</sup> Based on these representations, research was conducted in  
24         order to establish a factual basis for this testimony. However, the results of our  
25         research did not support the testimony of Dr. Taylor and Mr. Varner, in fact, our  
26         research strongly contradicts the representations they make with respect to the  
27         appropriate regulatory treatment of ISPs.  
28

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<sup>14</sup> *Id.* page 10.

<sup>15</sup> Varner direct testimony page 27.



1 First, based on FCC rules, it is not appropriate to treat ISPs as carriers. In the  
2 FCC's *Computer II Inquiry* (77 FCC 2 d 384, 387 – released May 2, 1980), the  
3 FCC found that ESPs (of which ISPs are a subset) are not common carriers within  
4 the meaning of Title II of the Communications Act. This FCC decision was  
5 codified in FCC rule 64.702. Section 64.702 of the FCC rules provides:

6  
7 [T]he term enhanced service shall refer to services offered over common  
8 carrier transmission facilities used in interstate communications which  
9 employ computer processing applications that act on the format, content,  
10 code, protocol or similar aspects of the subscriber's transmitted  
11 information; provide the subscriber additional, different or restructured  
12 information, or involve subscriber interaction with stored information.  
13 Enhanced services are not regulated under Title II of the Act. [emphasis  
14 added]  
15

16 Second, FCC regulations clearly specify that ISPs are to be treated as end users.  
17 The FCC's declaratory ruling at paragraph 15 specifically comments on the status  
18 of ISPs:  
19

20 The Commission's treatment of ESP [enhanced service providers, of  
21 which ISPs are a subset] traffic dates from 1983 when the Commission  
22 first adopted a different access regime for ESPs. Since then, the  
23 Commission has maintained the ESP exemption, pursuant to which it  
24 treats ESPs as end users under the access charge regime and permits them  
25 to purchase their links to the PSTN through intrastate local business tariffs  
26 rather than through interstate access tariffs. As such, the Commission  
27 discharged its interstate regulatory obligations through the applications of  
28 local business tariffs. Thus, although recognizing that it was interstate  
29 access, the Commission has treated ISP-bound traffic as though it were  
30 local. [emphasis added]  
31

32 This plain language clearly discredits the testimony of Dr. Taylor and Mr. Varner  
33 with respect to their characterization of ISPs as carriers rather than end users and

1 nullifies their arguments that ICG should share revenues it receives from its ISP  
2 customers with BellSouth.

3

4 **Q. Even if you were to ignore the FCC's clear language that ISPs are properly**  
5 **treated as end users – not carriers, would you agree with Dr. Taylor's**  
6 **analysis?**

7 A. No, I would neither agree that his analysis is the proper method of evaluating  
8 proper ISP compensation nor, given his analysis, that he reaches the proper  
9 conclusions. Even if we were to accept Dr. Taylor's analysis as relevant, Dr.  
10 Taylor chooses the wrong conceptual construct with which to appropriately  
11 evaluate this issue. As I described above, the FCC's order as well as sound public  
12 policy decision making and common sense indicate that traffic bound for an ISP is  
13 far more comparable to traffic bound for a local end user (i.e., the *ILEC-CLEC*  
14 *Interconnection Model*) than toll traffic carried by and IXC (i.e., the *ILEC-IXC*  
15 *Interconnection Model*).

16

17 **Q. Please describe in more detail why you disagree with Dr. Taylor regarding**  
18 **the use of the second construct (i.e., the *ILEC-IXC Interconnection Model*) for**  
19 **purposes of analyzing traffic bound for an ISP served by ICG.**

20 A. Simply put, each individual assumption relied upon by Dr. Taylor in reaching his  
21 conclusion that the *ILEC-IXC Interconnection Model* is the appropriate model to  
22 be used when evaluating traffic bound for an ISP customer is inaccurate.

23

24 First, ISPs are not IXCs contrary to the terminology Dr. Taylor places on the  
25 *ILEC-IXC Interconnection Model*. ISPs neither market, sell nor do they carry toll  
26 traffic. ISPs do not purchase switched access services and they do not establish  
27 physical switched access arrangements with the local exchange carriers that serves

1       them. IXCs, on the other hand, do market, sell and carry toll traffic. In fact, that  
2       is the very nature of an IXC. Likewise, IXCs do purchase switched access and  
3       establish physical switched access arrangements with the LECs that serve them.  
4       These arrangements are very different from the physical arrangements used by  
5       ISPs (i.e., switched access trunk groups as opposed to local, end user services).  
6       The fact that ISPs share none of these defining characteristics with an IXC simply  
7       highlights the point that Dr. Taylor and BellSouth are trying to fit a square peg  
8       into a round hole.

9  
10       Second, customers who subscribe to an ISP (whether they be customers served by  
11       BellSouth or ICG) do not purchase toll services from the ISP or from their local  
12       exchange carrier. They, like the ISP, purchase local exchange services.

13  
14       Third, contrary to Dr. Taylor's assumption, the ISP is an end user of the CLEC.  
15       Dr. Taylor's assumes the following as a fundamental basis for supporting the  
16       *ILEC-IXC Interconnection Model* as the most appropriate model for evaluating  
17       ISP bound traffic:

- 18  
19               2.       The ISP is viewed as a carrier – akin to an enhanced service  
20                       provider (“ESP”) – that routes the Internet call through the  
21                       backbone network to its final destination. The ISP performs the  
22                       standard carrier functions such as transport and routing, as well as  
23                       maintains leased facilities within the backbone network. It is  
24                       therefore not an end user of the CLEC. [emphasis added]  
25

26       Dr. Taylor is simply wrong. The FCC has already specifically found that the ISP  
27       is indeed an end user of the ILEC (or the CLEC, depending upon who provides  
28       the ISP access to the public switched network). In addition to the language I cited  
29       above, the following excerpt from paragraph 36 of the FCC's Declaratory Ruling

1 removes any doubt about the services ISPs purchase from local exchange carriers  
2 and their status as end users:  
3

4 With respect to current arrangements, we note that this order does not alter  
5 the long-standing determination that ESPs (including ISPs) can procure  
6 their connections to LEC end offices under intrastate end-user tariffs, and  
7 thus for those LECs subject to jurisdictional separations both the costs and  
8 the revenues associated with such connections will continue to be  
9 accounted for as intrastate.  
10

11 **Q. Does Dr. Taylor provide additional reasoning as to why the *ILEC-IXC***  
12 ***Interconnection Model* is superior to the *ILEC-CLEC Interconnection Model*?**

13 A. Dr. Taylor use what he terms the “principle of cost causation” to support his  
14 contention that the second construct described above (i.e., the *ILEC-IXC*  
15 *Interconnection Model*) is the appropriate model to use for purposes of resolving  
16 these issues. Specifically, Dr. Taylor uses his “principle of cost causation” to  
17 suggest that:  
18

19 ...for purposes of an Internet call, the subscriber is properly viewed as a  
20 customer of the ISP, not of the originating ILEC (or even of the CLEC  
21 serving the ISP). The ILEC and the CLEC simply provide access-like  
22 functions to help the Internet call on its way, just as they might provide  
23 originating or terminating carrier access to help an IXC carry an interstate  
24 long distance call. Therefore, with the proper network model being  
25 analogous to ILEC-IXC interconnection (access), rather than to ILEC-  
26 CLEC interconnection, the proper form of intercarrier compensation  
27 should be usage-based charges analogous to carrier access charges for long  
28 distance calls, rather than reciprocal compensation.<sup>16</sup>  
29

---

<sup>16</sup> *Id.* page 11

1 In further describing his theory of “cost causation” at page 13 of his testimony Dr.  
2 Taylor provides additional guidance with respect to evaluating the actions of the  
3 “cost causer” within the two scenarios described above:

4  
5 The major difference [between the two constructs above] is that in the  
6 ILEC-CLEC local interconnection regime, the cost-causing ILEC  
7 subscriber is also a customer of the originating ILEC for local services,  
8 while in the ILEC-IXC regime, that cost-causing subscriber acts as a  
9 customer of the IXC for long distance service.  
10

11 In addition to his “cost causation” theory, Dr. Taylor uses the following points in  
12 an attempt to further strengthen his plea that the Authority use construct number  
13 two above in basing a decision regarding the proper compensation for ISP bound  
14 traffic:

15  
16 The FCC has characterized the link from an end-user to an ISP as an  
17 interstate access service and, absent other considerations, ISPs would be  
18 subject to charges analogous to interstate access charges.<sup>17</sup>  
19

20 From an economic perspective, then, the party that causes the cost  
21 associated with ISP bound traffic is the originating ILEC’s subscriber who  
22 acts in the capacity of an ISP customer. In this sense, ISP-bound traffic  
23 has the same characteristics as IXC-bound traffic in the ILEC-IXC regime  
24 and has characteristics opposite to CLEC-bound traffic in the ILEC-CLEC  
25 local interconnection regime.<sup>18</sup>  
26  
27

28 **Q. Obviously you disagree that the second construct described above (i.e., the**  
29 **ILEC-IXC Interconnection Model) is the appropriate model upon which to**  
30 **base a decision regarding payments for ISP bound traffic. Do you disagree**  
31 **with Dr. Taylor’s points above?**

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<sup>17</sup> *Id.* page 13

<sup>18</sup> *Id.* page 14-15

1 A. Yes, I do. First, Dr. Taylor's entire cost causation argument can be summed up as  
2 follows: because the BellSouth "subscriber" is acting as a customer of the ISP  
3 when he/she makes a call to the ISP, the ISP should be responsible for  
4 compensating everyone involved in routing and transporting the call to the ISP's  
5 location. Because the ISP is the CLEC's customer, the CLEC should be  
6 responsible for charging the ISP some rate for delivering traffic to the ISP. The  
7 CLEC should then be responsible for compensating the LEC for originating the  
8 call.

9  
10 Dr. Taylor's theory has many holes. First, the BellSouth "subscriber" is not a  
11 customer only of the ISP but also of BellSouth. In fact, Dr. Taylor uses the word  
12 subscriber so as to avoid making obvious this first hole in his theory. Indeed, the  
13 "subscriber" is a *local exchange customer* of BellSouth. As a local exchange  
14 customer of BellSouth that local customer is allowed access to the public  
15 switched network and is capable of calling other parties and being called.  
16 Likewise, the ISP is a local exchange customer of the CLEC. As a local exchange  
17 customer of the CLEC the ISP is allowed access to the public switched network  
18 and is capable of making and receiving calls. When the BellSouth subscriber calls  
19 the CLEC ISP, both customers are using the local exchange facilities of BellSouth  
20 and the CLEC to carrying and transport traffic between the subscriber and the ISP.  
21 Not until the call reaches the ISP does the ISP actually provide the customer any  
22 service. Hence, contrary to Dr. Taylor's theory, the BellSouth subscriber is not  
23 acting as a customer of the ISP until he/she reaches the ISP's location (after  
24 having exercised his/her customer privileges provided by BellSouth). To get  
25 there, the subscriber is acting as a customer of BellSouth. As such, BellSouth is  
26 switching and routing the call pursuant to the subscriber's dialed directions. In  
27 doing so, BellSouth uses the CLEC (ICG) network and generates costs for the

CLEC. It is these costs that the CLEC must be allowed to recover from BellSouth as the provider of the customer who is the true cost causer – i.e., the local subscriber who first places a call.

**Q. Please discuss the shortcomings of Dr. Taylor's cost causation model more fully.**

A. As noted above, Dr. Taylor's argument revolves around the assumption that a customer of an ISP, when using the Internet, is acting solely as a customer of the ISP and not as a customer of the ILEC. Dr. Taylor's conclusions rely entirely on this assumption, because if the Internet user is acting as a customer of the ILEC when he or she makes the local call to the ISP, the ILEC (who recovers costs from its customer) would have caused costs, and therefore, be responsible for reciprocal compensation to the CLEC on whose system the call was terminated. Therefore, in order to accept Dr. Taylor's argument and his conclusions, it is critical to fully accept that an Internet user is not, during any portion of a call to an ISP, acting as a customer of the ILEC.

This assumption is difficult to accept. While it is clear that an ISP customer is acting as a customer of the ISP when using the Internet (when the call reaches the ISP), that same level of clarity does not exist when assuming the customer is not acting as a customer of the ILEC when dialing the seven-digit local number to reach the ISP's local POP. In fact, in order to use the Internet, the caller is completely reliant on the ILEC, and therefore, the argument could be made that the caller is acting *entirely* as a customer of the ILEC and simply contracting with a third party to provide a complimentary service, much the same as if a BellSouth customer contracted with an answering service (i.e., the answering service would be of little use to the customer without first and foremost being a customer of the

1 ILEC). In fact, to be a subscriber of any service which is complimentary to basic  
2 local telephone service, such as voice messaging, caller ID, call waiting and  
3 Internet services, it is a pre-existing condition (in the real world) that the  
4 subscriber of those services must first and foremost, act as a customer of an  
5 originating LEC. Certainly, at best, the portrayal of the Internet caller's customer  
6 status as put forth by Dr. Taylor is not as cut and dry as he would indicate. In  
7 fact, it would be much more reasonable to assume that the Internet caller is a  
8 customer of both the ISP and the ILEC and the services are inextricably  
9 commingled and really inseparable in the context of making an Internet call. This  
10 intrinsic relationship undoubtedly played a vital role in the FCC's determination  
11 in its ISP Order that ISP-bound traffic is jurisdictionally mixed. Because Dr.  
12 Taylor's assumptions cannot be validated in the real world, the Authority should  
13 reject his resulting conclusions.  
14

15 **Q. Does BellSouth make a clear distinction between a customer of its ISP and a**  
16 **customer of its ILEC services, consistent with Dr. Taylor's cost causation**  
17 **argument?**

18 A. No, it does not. The *BellSouth.net* website advertises promotions designed to  
19 attract customers to use the BellSouth ISP service, BellSouth ILEC services or  
20 both. These promotions offer customers free installation, significant monthly  
21 discounts on various BellSouth ILEC services if customers sign multi-year ISP  
22 contracts. One such promotion offers customers of BellSouth unlimited Internet  
23 access for \$15 per month. In order to qualify for this offer, BellSouth customers  
24 must subscribe to the BellSouth *Complete Choice* bill plan. One of the benefits of  
25 participating in this plan is that the customer's BellSouth Internet service is  
26 charged to the same telephone line, and appears on the same bill, as their  
27 Complete<sup>Choice</sup> service.



1  
2 BellSouth's actions in making this offering with respect to the jurisdictionally  
3 mixed nature of ISP-bound traffic are consistent with the FCC's treatment of such  
4 traffic. The two services are so intrinsically related that BellSouth offers a special  
5 service to users of its Internet and ILEC services that actually bills both charges to  
6 the same local line. This offering is a reflection of the actual cost causing status  
7 of the parties involved, and is entirely inconsistent with Dr. Taylor's view that  
8 Internet callers act solely as customers of the ISP.  
9

10 **Q. Are CLECs such as ICG the only carriers who have ISPs as customers?**

11 A. No. ILECs such as BellSouth also have ISP customers.  
12

13 **Q. Does BellSouth model its pricing and cost recovery efforts on the cost**  
14 **causation rationale Dr. Taylor advocates in this case?**

15 A. No. BellSouth charges its ISP customers local business line rates for local  
16 telephone exchange service that enables the ISPs' customers to access their  
17 service via a local call. In fact, as we saw above, BellSouth even markets the  
18 access to its ISP as being available via a "local call." The service provided to ISP  
19 customers by BellSouth falls under BellSouth's local exchange tariffs and calls to  
20 ISPs are rated and billed just as any other local call placed via a seven digit local  
21 telephone number.  
22

23 **Q. Dr. Taylor beginning at page 17 of his testimony describes why he believes**  
24 **the "ILEC-CLEC" model will "harm economic efficiency." Do you agree**  
25 **with Dr. Taylor's testimony in this respect?**

26 A. No, I do not. But before I explain the flaw in Dr. Taylor's argument I think it is  
27 interesting to note that in this section of his testimony (page 20) Dr. Taylor as

1 much as concedes that the parties who cause the costs that ICG incurs in carrying  
2 traffic bound for the Internet, are the persons making calls to the Internet (i.e.,  
3 primarily BellSouth local exchange customers).

4  
5 The subsidy to Internet use can be eliminated by charging differently for  
6 such use than for voice calls.<sup>19</sup>  
7

8 Obviously, what Dr. Taylor is saying in the quote above is that by charging a  
9 different price for calls made to the Internet, the cost causers (i.e., the originating  
10 caller) will be better attuned to the costs they generate on the network, thereby,  
11 removing the harmful effects that a subsidy would create (i.e., prices that were  
12 unable to reflect underlying costs thereby removing economically efficient  
13 decision making). This is directly inconsistent with Dr. Taylor's earlier argument  
14 that it is instead the ISPs who actually "cause" the costs of Internet usage.  
15

16 **Q. Does Dr. Taylor's inconsistent view of who actually causes the costs of**  
17 **Internet usage taint his entire analysis?**

18 A. Yes, it does. Dr. Taylor's arguments regarding economic efficiency and market  
19 distortion all revolve around his inconsistent, and mistaken, premise that ISPs are  
20 actually the cost causers of Internet usage. If, however, we properly view the  
21 caller originating the Internet call as the cost causer (as Dr. Taylor does in the  
22 excerpt above), the remainder of his arguments fall apart. If the Internet caller is  
23 ever to be properly attuned to the costs he/she causes on the network, it is self-  
24 evident that those costs must be made known to the caller and he/she must be  
25 required to bear them. This however, is not the result of BellSouth's or Dr.  
26 Taylor's proposal in this case. Instead, Dr. Taylor's proposal would simply have  
27 those costs borne solely by ICG. Such a proposal in no way adds to economic

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<sup>19</sup> Direct Testimony of William E. Taylor, Ph.D., page 20.

1 efficiency, even tangentially. ICG's proposal, on the other hand, would place  
2 costs associated with callers' access to the Internet where they belong; on the  
3 service provider who provides those callers (i.e., the cost causers) access to the  
4 network (i.e., BellSouth).

5  
6  
7 **Q. Please comment on Dr. Taylor's suggestion that reciprocal compensation for**  
8 **ISP-bound traffic would distort the local market and provide perverse**  
9 **incentives for CLECs to arbitrage the system?**

10 A. Dr. Taylor's arguments in this area revolve around his contention that CLECs  
11 such as ICG terminate more traffic than they originate, and that the termination  
12 costs of ISP-bound calls are less than BellSouth's average costs of termination.  
13 Therefore, according to Dr. Taylor, CLECs are overcompensated. He then goes  
14 on to argue that, given this current situation, CLECs have an economic incentive  
15 to arbitrage the system and to terminate as much ISP traffic as possible – to  
16 essentially specialize in serving exclusively ISP customers.

17  
18 Dr. Taylor simply asserts, without providing even as much as circumstantial  
19 evidence or authority, that ICG's costs for carrying ISP bound traffic are less than  
20 the reciprocal compensation rate. It has been the experience of our firm that this  
21 assertion simply isn't true. Regardless, without some type of evidence provided  
22 by Dr. Taylor regarding the validity of his assumption, upon which the remainder  
23 of his argument regarding arbitrage is based, his argument can't be given any  
24 weight.

25  
26 **Q. Is there a danger of market distortion without reciprocal compensation for**  
27 **ISP-bound traffic?**

1 A. Yes. I address this issue exhaustively in my direct testimony. As I noted in my  
2 direct testimony, BellSouth has agreed to provide reciprocal compensation for  
3 ICG's local business and residential traffic. Even though the cost characteristics  
4 of these calls and ISP-bound calls are identical, BellSouth distinguishes between  
5 these calls when paying reciprocal compensation as if the costs were different. As  
6 I described in my direct testimony, this would cause significant market distortion  
7 because by denying CLECs the ability to be compensated for the costs incurred in  
8 serving ISP customers, those customers become unattractive.

9  
10 The result of this market distortion has far reaching impacts. Because the ISP  
11 market segment often provides an important revenue stream to new market  
12 entrants, a significant blow would be dealt to the development of local  
13 competition in Tennessee if reciprocal compensation for ISP-bound traffic was  
14 not permitted. Without compensation for the costs incurred to carry BellSouth's  
15 traffic bound for the Internet, it may be very difficult for new entrants to expand  
16 their operations or to maintain current marketing initiatives.

17  
18 **Q. Dr. Taylor at page 21 of his testimony states that "...when traffic between the**  
19 **ILEC and the CLEC is grossly unbalanced, e.g., when the CLEC originates**  
20 **little or no traffic, the accuracy of the TELRIC study for the traffic served by**  
21 **that CLEC is critical." Do you have any comments regarding this**  
22 **testimony?**

23 A. In my Direct Testimony I suggested that one benefit of requiring reciprocal  
24 compensation payments for ISP bound traffic was that it provided BellSouth a  
25 rare incentive to more accurately estimate its own costs. Because it is BellSouth's  
26 cost studies that generally provide the basis for reciprocal compensation rates, in  
27 situations where BellSouth is required to pay (instead of receive payments) based

1 on those rates, it has an incentive to "re-evaluate" its studies to ensure they are as  
2 accurate (i.e., not over-estimated) as possible. In nearly every other circumstance,  
3 BellSouth's incentives are always to over-estimate its costs. Dr. Taylor's  
4 testimony above proves my point. Dr. Taylor now, because there is a possibility  
5 they will be used to set rates which BellSouth will be required to pay, questions  
6 the accuracy of the BellSouth studies. It is of further interest to note that even  
7 though Dr. Taylor implies throughout his testimony at pages 21 and 22 that  
8 BellSouth's cost studies may overestimate costs associated with carrying local  
9 traffic, instead of requesting that a new study be done, he instead simply uses this  
10 fact as another reason why BellSouth should pay nothing. This simply isn't a  
11 reasonable or consistent position.  
12

13 **Q. Earlier in your testimony, you stated that BellSouth and its witnesses in this**  
14 **case have twisted the FCC's recent decisions to the point that the BellSouth**  
15 **proposal cannot be taken seriously. Would you please expand upon that?**

16 A. Yes. BellSouth and its witnesses have constructed their arguments based on  
17 something that is simply not true. For example, Dr. Taylor has based his  
18 arguments regarding the reciprocal compensation issue, in large part, on the  
19 erroneous conclusion that "ISP-bound traffic is not local and, therefore, not  
20 eligible for reciprocal compensation"<sup>20</sup>. Dr. Taylor supports this conclusion by  
21 citing language from paragraphs 10 and 12 of the recent FCC *Declaratory Ruling*.  
22

23 This argument falls flat however if one reads the entire ISP Order. In fact, in my  
24 direct testimony, I acknowledged the findings of the FCC regarding the unique  
25 nature of Internet traffic<sup>21</sup>. However, if one were to read the entire ISP Order, one

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<sup>20</sup> Testimony of William E. Taylor, Ph.D. Page 23, lines 9-10.

<sup>21</sup> Testimony of Michael Starkey, Page 5 lines 18-20.

1 would find that in spite of the FCC finding regarding the nature of ISP-bound  
2 traffic, the FCC has concluded at paragraph 20;

3  
4 Our determination that at least a substantial portion of dial-up ISP-bound  
5 traffic is interstate does not, however, alter the current ESP exemption.  
6 ESPs, including ISPs, continue to be entitled to purchase their PSTN links  
7 through intrastate (local) tariffs rather than through interstate access tariffs.  
8 Nor, as we discuss below, is it dispositive of interconnection disputes  
9 currently before state commissions<sup>22</sup>. [emphasis added, footnotes  
10 removed]  
11

12 From this statement, it is evident that the FCC recognizes the jurisdictionally  
13 mixed nature of ISP-bound traffic, and then clearly and plainly goes on to reach  
14 conclusions that are not only inconsistent with the conclusions reached by Dr.  
15 Taylor, they are on completely opposite ends of the spectrum. Further, in order to  
16 be clear that the FCC does not intend to pre-empt state commissions ability to  
17 require reciprocal compensation for ISP-bound traffic, the FCC states at  
18 paragraph 25:  
19

20 Even where parties to interconnection agreements do not voluntarily agree  
21 on an inter-carrier compensation mechanism for ISP-bound traffic, state  
22 commissions nonetheless may determine in their arbitration proceedings at  
23 this point that reciprocal compensation should be paid for this traffic. The  
24 passage of the 1996 Act raised the novel issue of the applicability of its  
25 local competition provisions to the issue of inter-carrier compensation for  
26 ISP-bound traffic. Section 252 imposes upon state commissions the  
27 statutory duty to approve voluntarily-negotiated interconnection  
28 agreements and to arbitrate interconnection disputes. As we observed in  
29 the Local Competition Order, state commission authority over  
30 interconnection agreements pursuant to section 252 "extends to both  
31 interstate and intrastate matters." Thus the mere fact that ISP-bound  
32 traffic is largely interstate does not necessarily remove it from the section

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<sup>22</sup> FCC Docket No. 96-98, Declaratory Ruling, Released February 26, 1999.

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1 251/252 negotiation and arbitration process. However, any such  
2 arbitration must be consistent with governing federal law. While to date  
3 the Authority has not adopted a specific rule governing the matter, we do  
4 note that our policy of treating ISP-bound traffic as local for purposes of  
5 interstate access charges would, if applied in the separate context of  
6 reciprocal compensation, suggest that such compensation is due for that  
7 traffic<sup>23</sup>. [emphasis added, footnotes removed]  
8

9 This very clear language from the FCC was included in my direct testimony. I  
10 include it again here only to ensure that the Authority isn't mislead by Dr.  
11 Taylor's selectively interpreting the FCC's ISP Order, while completely ignoring  
12 the FCC's conclusions. The FCC has plainly determined that – even allowing for  
13 the unique characteristics of ISP-bound calls –states have jurisdiction and that  
14 states should allow reciprocal compensation for such traffic. Therefore, Dr.  
15 Taylor's testimony that the FCC has found ISP-bound calls more likely to be  
16 interstate than local is totally irrelevant to the issue of whether reciprocal  
17 compensation should be allowed for that traffic, and should be disregarded by the  
18 Authority.  
19

20 **Q. In effort to avoid paying reciprocal compensation for ISP-bound traffic in**  
21 **the past, has BellSouth mounted this same attack?**

22 A. Yes. In a recent proceeding before the Alabama Public Service Commission  
23 (APSC), BellSouth challenged the reciprocal compensation provisions of  
24 interconnection agreements it had entered into with ICG and other carriers  
25 regarding ISP-bound traffic. In that case, BellSouth argued that under federal  
26 law, ISP-bound traffic does not fall under reciprocal compensation provisions and  
27 therefore, BellSouth refused to pay reciprocal compensation for ISP-bound calls  
28 to ICG and others.

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<sup>23</sup> *Id.*, Paragraph 25.

1

2 ICG and other CLECs subsequently petitioned the APSC seeking a determination  
3 as to whether calls from BellSouth customers that happen to be ISP-bound are  
4 eligible for reciprocal compensation. The APSC issued an Order in this case on  
5 March 4, 1999 in which it determined that contrary to the arguments of BellSouth,  
6 ISP-bound traffic is subject to reciprocal compensation.

7

8 **Q. Did BellSouth challenge the APSC's Order?**

9 A. Yes. BellSouth unsuccessfully challenged the decision of the ASPC in Federal  
10 District Court. As is the case in this docket, BellSouth relied heavily on the recent  
11 determination by the FCC that Internet traffic is interstate rather than local, and  
12 therefore, not eligible for reciprocal compensation. The Court rejected this  
13 argument.

14

15 BellSouth continues to cling to this argument, and has attempted to support it with  
16 equally unconvincing arguments in this case by including the "cost causer"  
17 testimony of Dr. Taylor. I have clearly shown that these arguments are without  
18 merit, and that the arguments and conclusions reached by BellSouth and its  
19 witnesses with respect to reciprocal compensation for ISP-bound traffic should be  
20 disregarded by the Authority.

21

22 **Q. Has the Arbitration Panel in Alabama recently issued a Procedural Order**  
23 **directly contradicting Dr. Taylor's theory that ICG's ISP customers are the**  
24 **"cost causers" responsible for expenses resulting from ISP-bound traffic?**

25 A. Yes, it has. The Arbitration Panel in Alabama has decided that ICG and BellSouth  
26 should compensate one another for ISP bound traffic. However, it is of further



1 interest to note the Panel's rationale located at page 16 of the Order states as  
2 follows:

3 We are also persuaded that reciprocal compensation is economically  
4 efficient because it is cost based and imposes the cost of delivering traffic  
5 on the carrier whose subscriber causes the cost by initiating the call.  
6

7 This conclusion is consistent with the FCC's finding in paragraph 29 of its  
8 Declaratory Ruling that LECs incur costs when delivering another carrier's traffic  
9 to an ISP, and therefore, state commissions should adopt a mechanism allowing  
10 those LECs to recover those costs.  
11

12 **Q. Does this conclude your rebuttal testimony?**

13 **A. Yes.**  
14